

1 NEW YORK STATE SENATE
2 COMMITTEE ON INVESTIGATIONS AND GOVERNMENT OPERATIONS

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4 Public Hearing in the Matter
5 Regarding New York State's Failure to Collect Taxes
6 Generated by Cigarettes sold to Non-Native Americans
7 on Native American Reservations

8 _____

9 Legislative Office Building
10 Hearing Room B
11 Albany, New York

12 January 26, 2010
13 Tuesday
14 1:00 p.m.

15 PRESIDING: Senator Craig M. Johnson
16 Chairman

17 PRESENT: Senator Ruben Diaz
18 Senator Martin Golden
19 Senator Jeffrey Klein
20 Senator Michael Nozzolio
21 Senator William Stachowski

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1 CHAIRMAN JOHNSON: Good afternoon,

2 everybody, and welcome, ladies and gentlemen. On behalf
3 of the Senate Standing Committee on Investigations and
4 Government Operations, I welcome you to today's hearing.

5 My name is Senator Craig Johnson. I'm
6 privileged to serve as the Chairman of this fine
7 committee. With me this afternoon so far are ranking
8 member George Winner, the former Chairman of this
9 Committee, as well as Michael Nozzolio, and we expect a
10 couple other members as well.

11 As our hearing notice advises, we are here
12 today for an inquiry into the state's two decade plus
13 failure to collect taxes generated by cigarettes sold to
14 non-native Americans on Native American reservations.
15 These sales also currently include a substantial
16 internet component.

17 Today is the second of such hearings on this
18 topic. The first, as you may recall, was held on
19 October 27th in New York City. While many other states
20 have been able to negotiate mutually beneficial compacts
21 with their Native American nations, New York has not.

22 Over the years, there has been talk. There
23 have been threats. We have even passed laws to aid in
24 this collection, laws that have been upheld by the

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1 United States Supreme Court.

2 Now, interestingly, there have been some
3 changes since the last time this committee convened on

4 this topic. Governor David Paterson, in his budget
5 address, disclosed that he ordered the policy of
6 forbearance that has prevented the Department of
7 Taxation and Finance from attempting to collect this
8 revenue to be lifted.

9 Perhaps the hearing this committee held on
10 October 27th played a part in his decision; however, it
11 remains very unclear how the Governor's reversal will be
12 implemented and what steps will come next.

13 Unfortunately, attempts to clarify these
14 questions with the relevant Executive Branch authorities
15 have been unsuccessful to date. As many of you know,
16 the scope of this inquiry has also evolved. While still
17 focusing on the issue of tobacco taxes, we have also
18 begun to look into other aspects of the relationship and
19 services that the state and its Native American nations
20 provide to each other.

21 As I said before, the goal of these hearings
22 is to help the state and these nations chart a new path
23 and find a real and lasting solution to this issue. In
24 our previous hearing, we heard from a full spectrum of

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1 state and local government officials, private sector
2 interests, and representatives from the Native American
3 nations to address this committee; provide us with the
4 relevant information that we need; and to answer any
5 questions that the members of this panel may have.

6 Due to the time constraints at this previous

7 hearing we were not able to fit everybody in. Today, we
8 are picking up where the previous hearing left off.

9 Once again, the members of this committee are
10 fully aware that emotions run high on this issue, and
11 that resentments likely run very deep. It's our hope to
12 continue to undertake a respectful public dialog through
13 a public hearing to resolve this issue.

14 We hope that the emphasis will be on shedding
15 maximum light and minimum voltage heat to this hearing
16 process. I urge all witnesses who testify today to be
17 focused and factual, avoiding the rhetorical flourishes
18 which may impede a global solution to a complex and long
19 standing fiscal problem.

20 Following each statement, initial statement,
21 I will recognize each Senator for a round of questions.

22 Before we do, I want to allow Senator Winner,
23 if you had an opening statement.

24 Before, Mr. Calvin, we get to you, there's

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1 one piece of business I want to address. I believe it's
2 important for the record. At the last hearing, under
3 questioning by myself to Peter Kiernan, counsel to the
4 Governor, there was information that was requested
5 concerning the issue of whether or not the Native
6 American nations have been paying fees owed to New York
7 State with respect to security and fingerprinting.

8 These are fees that were agreed upon in the

9 compacts between the state and the respective Native
10 American tribes.

11 First of all, we are joined by Senator Marty
12 Golden as well. And the gentleman to my immediate left
13 is Roger Adler, counsel to the committee.

14 Mr. Adler, I believe we were provided with a
15 document that addresses this issue. If you could maybe
16 clarify that.

17 MR. ADLER: Chairman, we will have premarked
18 this as Exhibit 1 for the hearing today a one page
19 document provided to us by the State Police, which
20 indicates in pertinent part the Mohawk nation as of the
21 end of the third quarter, 12/31/09, according to State
22 Police, owes \$14,264,080.87; the Oneidas, \$739,328.23,
23 the Seneca Niagaras, \$22,823,246.84; the Seneca
24 Allegheny, \$18,103,550.75, for a grand total owed to the

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1 state, not paid, of \$55,930,206.69, almost \$56 million.

2 Mr. Chairman, this document will be
3 introduced as Exhibit 1 at the public hearing today.

4 CHAIRMAN JOHNSON: This document does
5 confirm Mr. Kiernan's testimony with respect to the
6 Seneca nation holding back into escrow, or allegedly
7 into escrow, \$40 million that is owed with respect to
8 the security fees and fingerprinting fees.

9 Mr. Adler, one thing just to clarify, with
10 respect to the document, and this -- it was testimony
11 that was delivered that there has been a long standing

12 dispute among New York State and the Mohawks, as well as
13 the Senecas, with respect to this obligation; but
14 interestingly, correct me if I'm wrong, but the Oneidas,
15 according to this document, have paid -- have not owed
16 anything for security or fingerprinting up until the
17 third quarter 2009, correct?

18 MR. ADLER: That is correct. Up until the
19 second quarter, beginning July 1, 2009, they had a zero
20 balance. And the first item that appears is \$739,326.23
21 beginning in the summer of 2009. Up until then,
22 according to State Police records, they had been
23 absolutely current.

24 CHAIRMAN JOHNSON: Thank you.

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1 I just want to recognize, because I didn't
2 know he was here, J.T. Seneca from the Seneca nation. I
3 want to thank Mr. Seneca for joining us again in the
4 hearing.

5 I know also someone just came in who wanted
6 to have a moment and has taken a break from his hearing,
7 the Chairman of the Finance Committee, Senator Carl
8 Kruger, has joined us.

9 Senator, did you want to make a statement at
10 this time?

11 SENATOR KRUGER: Could that be possible?

12 CHAIRMAN JOHNSON: After that, Mr. Calvin, I
13 promise we will turn it over to you.

14 SENATOR KRUGER: I will be brief. I want to
15 thank, first of all, the Chairman for giving me the
16 opportunity to make a few remarks, but more particularly
17 to express the deep concern that I have, and I have
18 shared with my colleagues in the legislature for the
19 better part of 15 years that I have been here, when we
20 talk about the question of collection and the
21 non-collection of taxes on Native American reservations.

22 As the budget becomes more and more dire,
23 and as we further recognize the fact that there -- that
24 we have lost billions of dollars in uncollected revenue,

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1 there never was a good time to begin the process. The
2 process should have begun right away.

3 We have gone through the courts and they
4 have sided with us. The legislature has adopted the
5 appropriate laws and the administrations have denied us
6 access to this funding stream.

7 Attempts to take that money legally was -- I
8 think we had about ten minutes worth of collections at
9 one point and then it was decided that the inability of
10 the state to collect the monies was because of the --
11 perhaps the -- I best categorize it, but the
12 unwillingness to have those that are in a position to
13 collect for us decide that they are not willing to do
14 that.

15 We now have been given an opportunity to
16 readdress this issue, and I want to thank Senator

17 Johnson and the committee for moving forward with the
18 agenda.

19 In November of last year I presented a
20 letter to the Governor asking him to rescind the
21 forbearance and to allow the tax department to start
22 collecting those taxes.

23 I also at the time issued a FOIL request for
24 the books and records from the Department of Taxation

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1 and Finance so that we could make a determination or at
2 least an observation of what was collectible and what
3 hadn't been collected.

4 My estimation, the industry estimation, and
5 those that are in a position to know, talk in the
6 neighborhood of over a billion dollars. And it may run
7 as high as \$1.5 or 1.6 billion. It's a sad comment that
8 any Governor would stand in the way of the collection of
9 those taxes.

10 We recognize the court ordered obligation to
11 offer coupons to Native Americans so that they can
12 purchase their cigarettes and tobacco outside of the
13 collection process, and we've asked the Governor to move
14 forward with that and to start printing the coupons.

15 We have also asked him to allow Taxation and
16 Finance to begin the collection process; simultaneously
17 the Attorney General would go to court in a ministerial
18 fashion to release the injunction that is being held;

19 and consequently, the agents are ready to begin stamping
20 those cigarettes in short order. I would say tomorrow,
21 but I would think 30 days would be a reasonable amount
22 of time.

23 Every day that goes by we're not collecting
24 that money, every day that goes by we're not doing the

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1 right thing by the people in the State of New York.

2 At the same time, while we talk about the
3 healthcare concerns and the needs of all New Yorkers, I
4 just want to make a point that I would hope that nobody
5 smokes. I would hope that we don't sell a pack of
6 cigarettes in the State of New York. I would hope this
7 Thursday when I'm joined at a rally in the city by the
8 Cancer Society and by the Heart Association and by
9 advocates across the state, we all have one common
10 interest, and that's health. And if nobody smoked we
11 wouldn't have to have this hearing and there would be no
12 money to collect.

13 But people are going to smoke and there are
14 millions of packs of cigarettes being sold in this state
15 that are going untaxed, and that's wrong. That's wrong
16 when we want to take teachers out of the classroom, when
17 we want to close hospitals, we want to retool
18 government, we have to basically cut down to the bone
19 rather than the fat in order to try to close a \$7.4
20 billion gap that exists this fiscal year, with even
21 larger gaps in the out years.

22 So, I came today to once again thank the
23 Senator and the committee for energizing the issue, to
24 use the media and the advocates to send a clear and

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1 compelling message to the Governor that, as far as I'm
2 concerned as the Chairman of the Senate Finance
3 Committee, he has not put one dollar in this budget that
4 is a revenue stream coming out of those collections.

5 Rather than -- with audacity and with
6 reckless disregard, there has been money put into the
7 budget to further tax those people that are already
8 paying tax on cigarettes.

9 So, my message to him is that we should
10 collect before we tax. We should collect before we tax.
11 And I believe that we are going to do that, and I don't
12 think that we will be passing a budget in Albany this
13 year that does not have a revenue stream that comes from
14 that uncollected cigarette tax, because, if we do, then
15 I think that we have to say shame on us because we are
16 pointing fingers at folks that are paying the rightful
17 taxes on the product that they are buying and we're
18 ignoring a conspiracy that exists among us to sell those
19 untaxed cigarettes.

20 The agents that are being used as conduits
21 as part of this diabolical scheme will be exposed.
22 Those that want to cooperate will obviously be able to
23 tax their product, stamp their product.

24

Mr. Chairman, I know that this committee has

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1 investigated. They know too well all the points that
2 were made in both the Governor's opening statement on
3 the budget; and the remarks that were subsequently made
4 talk about a willingness to look at the process, but the
5 devil is always buried in the details. Details, we
6 don't see a revenue stream this year out of those
7 untaxed cigarettes.

8 So, I urge everyone to sort of focus your
9 attention on the fact that New Yorkers are entitled, are
10 entitled for the government to obey the law, and the law
11 of the State of New York is that we should be taxing
12 cigarettes, and the law should not be treated in the
13 breach by anyone, and particularly the Chief Executive
14 in the position to be able to make that happen.

15 I want to thank you, Mr. Chairman, members
16 of the committee, for extending me this opportunity. I
17 am going back to our budget hearings where we are
18 hearing the hue and cry yesterday from the Mayor. City
19 of New York has filed -- the city has filed a lawsuit on
20 this very issue.

21 If there is common ground anywhere between
22 the world of Mike Bloomberg and Carl Kruger, which there
23 isn't much, it certainly focuses around the collection
24 of these taxes.

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1 CHAIRMAN JOHNSON: Politics means strange
2 bedfellows.

3 SENATOR KRUGER: It certainly does.

4 (Applause)

5 CHAIRMAN JOHNSON: Senator Golden, go on
6 ahead.

7 SENATOR GOLDEN: My views are very similar
8 to what Senator Carl Kruger has just stated. I would
9 like to hear testimony and look to see how we can
10 somehow come up with the ability to have this collection
11 or a compact with the Indian nations to work out some
12 type of an agreement whereby we, as the state, can be
13 reimbursed on these taxes.

14 I believe the wholesale market and
15 distributors have posted a loss excise tax and sales tax
16 revenue in 2009 amounts to almost \$1.6 billion. If we
17 take a look at the number of cartons that are here,
18 taxed cartons of cigarettes in 2000-2001 were 90 million
19 and today, 2008-2009, it's 49 million cartons of
20 cigarettes that are taxed.

21 Do we all really believe that somehow this
22 great state stopped smoking 41 million cartons a year?
23 I don't think so. I believe there is a fairness here
24 and I think that's what we have to try to get to is a

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1 fairness by which we are given the ability to collect
2 needed dollars for the State of New York.

3 And I welcome all of the people that are
4 here today, but if you take the number of 41 million,
5 let's just say there is a drop off, give them, I don't
6 know drop it to 30 million, and times that by the excise
7 tax, about \$27 a carton of cigarettes, and just come up
8 to the numbers yourself, you will be able to see that
9 it's well over a billion dollars that the loss is to the
10 State of New York.

11 And got to be clear here it's not just
12 Indian reservations, it's internet sales, it's cross
13 state sales. It is a host of different avenues that are
14 costing this state great losses.

15 And when you increase a tax, obviously you
16 will find people looking for other areas to purchase
17 that product so that they can get the best price.

18 And not to prolong this opening statement,
19 but we just had a hearing downstate on Friday about a
20 fat tax, where we want to turn to because there is
21 nothing left in the State of New York to tax except the
22 air we breathe. So, now we're going to try to tax soda
23 and other instruments that I believe is just ludicrous.

24 It will cost an additional \$.67 for a two

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1 liter bottle of soda in tax, \$450 million, a billion
2 dollars next year. So, what we have to do is stop
3 spending here in the State of New York, but right now we
4 do have a tremendous gap.

5 And the way to make up that gap is by

6 getting what we believe are fair dollars for merchandise
7 that is sold here in the City of New York and the State
8 of New York, and that amounts to well over a billion
9 dollars in revenue. And I believe we should at least
10 move as a state and require that these payments be made
11 in a fair and appropriate manner.

12 Thank you, Mr. Chairman, for the opportunity
13 to speak here, but I believe it goes without saying
14 everybody in this room and across the state -- layoff
15 teachers, firemen, police officers, over the ability or
16 inability to collect the taxes that are due us, shame on
17 us. Shame on the Governor. Shame on this legislature.

18 Thank you.

19 CHAIRMAN JOHNSON: Senator Nozzolio.

20 SENATOR NOZZOLIO: No.

21 CHAIRMAN JOHNSON: Senator Diaz, did you
22 want to make any opening remarks?

23 SENATOR DIAZ: Thank you, Mr. Chairman.

24 One more time we come talking about or

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1 concluding that the state had to balance the budget
2 without hurting the needy. I just heard Senator Golden
3 saying if it doesn't happen, shame on the state. Shame
4 on the legislature.

5 I hope that -- that is his point of view.
6 That's my point of view, too, but I hope that this
7 doesn't become another teary -- another just blah blah

8 blah. So, Senator Golden and all my colleagues, it's
9 important for the state and important for people that
10 are suffering that we collect this money.

11 So, I urge you and challenge you not to say
12 that it would be shame on the legislature to do
13 something about it, and the budget come all vote against
14 it. Until this happen, let's do something that show
15 that we really care. But to come and say this is
16 shameful, and then when the budget come say amen, that's
17 shameful. That is shameful.

18 My colleagues, I am here. This should be
19 done. It's a long time overdue. Only us could do it.

20 Let's do it. Thank you.

21 (Applause)

22 MR. ADLER: Gentlemen, please state your
23 names after I administer the oath, and your affiliation
24 and your office address.

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1 (JAMES CALVIN AND RENE PATTERSON duly
2 sworn.)

3 MR. CALVIN: I'm Jim Calvin, President of
4 the New York Association of Convenience Stores.

5 MR. PATTERSON: Rene Patterson, the General
6 Manager of Quickway Food Stores, out of Binghamton, New
7 York.

8 MR. CALVIN: Rene also serves as the
9 legislative chairman of NYACS.

10 CHAIRMAN JOHNSON: Jim, I'll let you make a

11 statement or however you want to proceed.

12 MR. CALVIN: Chairman Johnson, honorable
13 members of the committee, thank you for the privilege of
14 speaking today. I applaud your persistent and
15 bipartisan effort to individually and collectively
16 spotlight this critical issue and push for a lasting and
17 just solution.

18 With me today, in addition to Mr. Patterson,
19 are about 40 or 45 convenient store operators from
20 around the state -- from Jamestown and from Canton and
21 Rockville Center, Binghamton, Albany, and Canastota, and
22 all points in between -- because they care about this
23 issue that has been impacting them so greatly to an
24 increasing degree over the years.

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1 These small business people share your
2 commitment to the rule of law. They share your respect
3 for Native American people and their right to operate a
4 commercial enterprise. They share your belief that all
5 those who do business with New Yorkers should abide by
6 duly enacted standards governing such commerce.

7 For the past 15 years or more, our members
8 had to do business with one hand tied behind their back
9 by their state government. They obtain a license to
10 sell tobacco products; they comply with the myriad of
11 regulations; they collect and remit all the applicable
12 taxes.

13 They provide employment; they risk capital;
14 they work seven days a week; and their reward is a state
15 tax policy that chases their customers away to
16 unlicensed, unregulated, tax free tribal stores they
17 cannot possibly compete with. Historically, cigarettes
18 have been a core product category for our industry.
19 Nationally, they still account for 30 to 35 percent of
20 total sales inside the four walls of typical convenient
21 stores.

22 Not in New York. Here, many of our members
23 have lost two thirds to three quarters of their previous
24 cigarette sales volume. A small fraction of that is

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1 attributable to a drop in consumption. Most of it is
2 attributable to tax evasion.

3 Here's what happened: The State of New York
4 quintupled the excise tax on cigarettes in the span of
5 eight years without closing off well established
6 channels for evading that tax. In doing so, it incited
7 and abetted a tax evasion epidemic that has grown so
8 prevalent that more than half of New York smokers openly
9 admit to buying from untaxed sources and an entire
10 generation of smokers view tax avoidance as a way of
11 life.

12 This tax evasion epidemic has crippled small
13 businesses, squandered desperately needed tax revenue,
14 and thwarted anti-smoking initiatives. Whenever someone
15 buys a pack of cigarettes tax free the state loses \$2.75

16 in excise tax and the state and local governments lose
17 another 50 cents or so in sales tax revenue.

18 In addition, tax collecting licensed
19 retailers are deprived of a legitimate sale and,
20 cumulatively, the tax evasion epidemic has cost our
21 industry many billions of dollars in business, impeding
22 their ability to provide jobs and reinvest in their
23 communities.

24 Plus, the goal of reducing adult smoking is

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1 defeated because if people can buy cigarettes without
2 paying tax, there is no financial incentive for them to
3 quit smoking. The Supreme Court in the 1994 Attea case
4 unanimously ruled that New York State is entitled to
5 collect taxes on sales of cigarettes by Native American
6 tribes to non-Native American customers.

7 With then Senator Paterson voting in the
8 affirmative, the state enacted a law to exercise this
9 right that took effect March 1, 2006, but to date, the
10 tax department, in defiance of the constitution, refuses
11 to implement.

12 The reasons, expressed or implied, on any
13 given day seem to fall into five categories.

14 Reason number one. The tribes have
15 sovereign immunity. All New Yorkers have the deepest
16 respect for Native Americans to govern themselves and
17 operate businesses, but contrary to tribal assertions,

18 the Supreme Court has said that their sovereign immunity
19 is not absolute. In the Attea case it said the state's
20 interest in ensuring compliance with lawful taxes
21 outweighs the tribe's interest in offering a tax
22 exemption to customers who would ordinarily shop
23 elsewhere. It went on to say that New York had devised
24 a reasonable system for collecting the taxes without

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1 unnecessarily intruding on core tribal interests.

2 The Seneca Indian nation routinely claims
3 that the Attea ruling is trumped by the Treaty of 1842
4 concluded at Buffalo Creek. They argue that it
5 expressly forbids the state from imposing sales tax on
6 their trade with non-Indians.

7 Our understanding is different. Our
8 understanding is that New York's courts have refuted
9 that claim, stating unequivocally that that treaty
10 refers solely to exempting Indian land, not commerce,
11 from taxation. We have furnished your committee staff
12 with those court rulings.

13 Reason number two. If we enforce the law,
14 violence may occur. In the post 9/11 era New York has
15 zero tolerance for violence as a tool for influencing
16 government policy.

17 Section 490.20 of the Penal Law titled
18 Making a Terroristic Threat, makes it a class D felony
19 for anyone to try to influence the policy of government
20 by intimidation or coercion by threatening to commit

21 certain violent crimes, including assault, use of
22 firearms, and arson.

23 Thus, if violence or threats of violence
24 were to arise from any quarter over this or any other

23

1 matter, our state now has a mechanism for prosecuting
2 the offenders in order to protect its citizens from
3 terrorism and preserve the rule of law.

4 Reason number three. The tribes are a major
5 economic force. Some tribes point to the economic
6 benefits of their casino, smoke shop and other business
7 enterprises as a reason for the state not to enforce the
8 tax collection law. One boasts that its commercial
9 empire contributes over a billion dollars a year to the
10 New York economy.

11 Everyone genuinely appreciates the economic
12 contributions of the Oneidas in Central New York; the
13 Senecas in Western New York; and other Indian nations
14 you have heard from. They also value the presence of
15 IBM, General Electric, Citigroup and other Fortune 500
16 companies that are headquartered here.

17 Being an economic powerhouse, however, does
18 not excuse any entity from abiding by the standards
19 enacted by this legislature for engaging in commerce
20 with New Yorkers.

21 Reason number four. The state is enjoined
22 from enforcing the law. The tax department claims it's

23 enjoined from collecting these taxes on cigarettes and
24 gas purchased by non-Indian customers at tribal stores.

24

1 In reality, the department has chosen to enjoin itself.
2 The supposed shackles are a convenient illusion used to
3 rationalize this shameful policy of non-enforcement.

4 In January 2007, in the Day Wholesale case,
5 State Supreme Court Justice Rose Sconiers issued a
6 preliminary injunction barring the state from enforcing
7 the cigarette tax collection law until the department,
8 as prescribed by the statute, issues the tax exemption
9 coupons to tribes.

10 The coupon system is intended to preserve
11 the undisputed tax exemption on Indian sales to other
12 tribal members. The remedy was, and still is, obvious.
13 The department at its will can go ahead and implement
14 the law by issuing the coupons to tribes and start
15 collecting the taxes. All this time, the department had
16 the ruby slippers, but elected not to click them
17 together.

18 Reason number five. It wouldn't generate
19 much revenue anyway. Well, we commissioned an
20 economist, Dr. Brian O'Connor, to quantify the magnitude
21 of cigarette tax evasion on Indian lands in New York.
22 His March 2009 report, which we have shared with the
23 committee staff, showed the state would generate around
24 one billion a year in additional revenue by enforcing

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1 tax collection law. That's \$2.7 million today and every
2 day.

3 This figure is actually higher if one
4 factors in the unknown amount of lost taxes on motor
5 fuel sold tax free at tribal outlets, as well as state
6 and local sales tax on other products those gas and
7 cigarette customers would have purchased while visiting
8 tax collecting stores.

9 Now, contrary to Dr. O'Connor's assertions,
10 the administration seems convinced that enforcing the
11 law would only yield about \$200 million a year. That
12 doesn't jive with estimates by its own health department
13 that cigarette tax loss was between 436 million and 576
14 million in 2004; nor the City of New York's estimate
15 that the city alone is losing \$195 million a year due to
16 untaxed sales of cigarettes on Indian reservations.

17 In fact, way back in 1997 the Tax
18 Commissioner at the time, the late Michael Urbach, said
19 cigarette tax evasion was costing the state upwards of
20 \$100 million per year in lost tax revenue. The state
21 tax on cigarettes then was only \$.56. Today it's \$2.75.

22 So, you can see objective analysis of each
23 of these supposed justifications for not enforcing the
24 tax law reveals them to be exaggerations and excuses

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1 rather than valid reasons. Whatever the true motivation

2 for refusing to act, it's taking an enormous toll on
3 small businesses, taxpayers and public health.

4 Moreover, it undermines the credibility of
5 the tax department and its team of dedicated
6 professionals. Every time they say they need to come
7 and audit our sales tax records in order to make sure
8 New York State is getting all the tax revenue it's
9 entitled to, we shake our heads in dismay.

10 As Chairman Johnson alluded to, a ray of
11 hope appeared last week in Governor Paterson's budget
12 message. He said the tax department is going to rescind
13 its long standing policy of forbearance and promulgate
14 regulations to implement the tax collection system
15 prescribed by the law, including serving tax exemption
16 coupons.

17 While we don't question Governor Paterson's
18 sincerity, and we want to be hopeful, 15 years of
19 deliberate delay and deceit by his predecessors have
20 taught us to be skeptical of any new promises from the
21 Capitol on this issue.

22 We certainly applaud the intent and await
23 the follow through. We are puzzled, however, as to why
24 the Governor simultaneously proposed another one dollar

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1 a pack increase in the state excise tax on cigarettes,
2 because that would unquestionably worsen the cigarette
3 tax evasion epidemic by chasing more smokers to the tax
4 free side of the street as did each of the three

5 previous tax hikes over the past ten years.

6 The Governor proposes an effective date of
7 June 2nd for the tax hike, but indicates the start of
8 the enforcement initiative is at least six to nine
9 months off. That sequence is backward. It would be
10 like loading more passengers on a bus for a trip down
11 the mountain, and as you wave goodbye to them telling
12 them not to worry because you are beginning to schedule
13 an appointment to get the brakes fixed.

14 We say first things first. Enforce the law;
15 recapture the hundreds of millions of dollars in
16 cigarette tax revenue then escaping at the current tax
17 rate; achieve full compliance; and then examine whether
18 any change in the tax rate is really necessary.
19 Enacting the tax rate first would be a great mistake.

20 During the struggle for tax equality, the
21 legislature, to its credit, has tried everything to
22 restore tax fairness. You've passed legislation;
23 overridden vetoes; passed more legislation; held
24 hearings like this.

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1 On behalf of our members statewide, thank
2 you. What more can you possibly do? One immediate
3 thing you can do is prevent it from getting any worse by
4 rejecting Governor Paterson's call for another cigarette
5 tax increase until cigarette tax evasion has been
6 curtailed, And in the interest of restoring fairness to

7 the marketplace, fulfilling public health policy
8 objectives, and maximizing tax revenue for state and
9 local government, and insist he follow through
10 immediately on his pledge to move forward with lawful
11 collection of these taxes.

12 Thank you for your concern. Thank you for
13 your support. And thank you for the opportunity to
14 comment.

15 CHAIRMAN JOHNSON: Would you like to add
16 anything, sir?

17 MR. PATTERSON: No.

18 CHAIRMAN JOHNSON: He said it all for you,
19 right?

20 I just have a couple quick questions and
21 I'll turn it over to members of the committee.

22 Before I do, I just want to welcome the
23 Deputy Majority Leader of the New York State Senate,
24 Jeffrey Klein, and my good friend also, Senator Bill

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1 Stachowski from Buffalo and Senator Klein from the
2 Bronx.

3 I just have a couple quick questions for you
4 and then I will turn it over to members of the
5 committee.

6 By your testimony you indicated about 7700
7 convenient stores and mini marts across New York State?

8 MR. CALVIN: Yes.

9 CHAIRMAN JOHNSON: How many employees do

10 these stores have generally or statewide associated with
11 the stores?

12 MR. CALVIN: A convenient store would have
13 anywhere from eight to ten full- and part-time. Small
14 bodegas in New York City would have fewer. Some of the
15 larger stores upstate would have as many as 12 or 15.

16 Average eight to nine employees?

17 MR. PATTERSON: Yes.

18 CHAIRMAN JOHNSON: From your perspective,
19 what impact on jobs, on the economy, has the state
20 selected tax enforcement policies had on retail stores
21 that make up your organization?

22 MR. PATTERSON: It would negatively impact.
23 Businesses have actually closed. Convenient stores
24 closed because of the loss of sales because when the

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1 consumer comes in to buy tobacco, not only buy tobacco
2 but other goods in the store. All adds up to lost
3 sales.

4 CHAIRMAN JOHNSON: Senator Winner and then
5 Senator Klein.

6 SENATOR WINNER: Couple of questions, Jim.

7 I think there has been a lot of banter about
8 -- and your report, your study, indicating the amount of
9 collection of approximately a billion dollars, I think
10 it is. There is discrepancies in different quarters,
11 and the Governor's Office has about a \$200 million

12 number and the Health Department has a different type of
13 number. I guess it depends on who you're talking to as
14 to what kind of number it is.

15 But your assertion that tax evasion is
16 producing a billion dollar plus loss of revenue to the
17 state, does that take into account just the -- when you
18 say evasion, not just the sales on Indian reservations
19 but also the sales at markets out of state?

20 How do you differentiate --

21 MR. CALVIN: This does not include out of
22 state. Doesn't include bordering sales, no.

23 SENATOR WINNER: I mean you would contend,
24 as you have every year when there's a tax increase on

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1 the table, that the tax increase, particularly for those
2 of us who live in border areas, exacerbates your
3 circumstance because people are obviously crossing over
4 in my instance to Pennsylvania to buy cigarettes at a
5 large pace.

6 And obviously, those revenue losses are
7 attributable to the non-competitive differential price
8 in New York and Pennsylvania, but is that factored in
9 under your loss? Those sales are not factored into your
10 loss of a billion, correct?

11 MR. CALVIN: It is not. So, in reality, we
12 believe it's considerably higher than that. The
13 cigarette tax evasion pie has several slices -- Native
14 American sales, Internet, bootlegging, the black market

15 and cross border sales.

16 SENATOR WINNER: In that report, does that
17 report indicate the total amount of cartons of
18 cigarettes that are -- reportedly would be sold without
19 any tax evasion?

20 In other words, does it go above -- what is
21 the total number that you contend, if there was parity
22 all around, would be sold by your organization and other
23 businesses within New York and consumed in New York
24 State?

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1 MR. CALVIN: I can't recall from the report
2 the estimate of the number of cartons that would be sold
3 on the tax collecting side of the street. Obviously,
4 not all of them come back because some people would quit
5 smoking because they would have to pay the tax. We can
6 get you that section of the report. I can send that to
7 you with more precise estimates.

8 CHAIRMAN JOHNSON: Senator Klein.

9 SENATOR KLEIN: I have one question, sort of
10 two parts. The first, data on when we actually -- the
11 State of New York raises the tax on cigarettes, it has
12 sort of a double impact.

13 First, I think studies show that fewer
14 people smoke. Those people quit smoking because of the
15 higher tax, which is an incentive.

16 Second, of course, we are seeing that people

17 turn to alternative ways to buy cigarettes by buying
18 untaxed cigarettes over the Internet or through the
19 Native American reservation, sales on the reservations.

20 Do you have any data which actually shows
21 that we are not accomplishing any of those two purposes,
22 we're not, A, generating more revenue to the State of
23 New York which is, of course, the purpose of raising the
24 tax; or, the more noble one, of making sure that fewer

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1 people smoke?

2 MR. CALVIN: With each of the three
3 cigarette tax increases over the past ten years there
4 has been an increase in tax from cigarette tax revenue
5 as a result, but that increase in tax revenue has only
6 been a fraction of the percentage that you increase the
7 cigarette tax rate. A small portion of that, we
8 believe, although we don't have statistical data, it's
9 kind of impossible to prove, but we believe only a small
10 percentage of that is attributable to a drop in
11 consumption, people quitting smoking.

12 We believe that the vast majority is
13 attributable to tax evasion. And while --

14 SENATOR KLEIN: It's hard to quantify
15 because no one keeps track of untaxed cigarettes.

16 MR. CALVIN: It is, but we based that theory
17 on the anecdotal experience, the painful experience of
18 retailers like Rene Patterson. In June of 2008, which
19 was the last increase in state excise tax, went from

20 \$1.50 to \$2.75, when that took effect in June of 2008
21 there was an immediate drop of anywhere from 20 percent
22 to 40 percent in cigarette sales at tax collecting
23 convenient stores in New York State.

24 And I suppose it's theoretically possible

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1 that 20 to 40 percent of smokers quit smoking overnight,
2 but we don't think that's very probable. And we have
3 seen that each time there's been an increase in state
4 cigarette tax. And this past year, there was an
5 increase, a federal tax increase, there was an immediate
6 drop off, a significant drop off in cigarette sales in
7 convenient stores that cannot possibly all be accounted
8 for by people quitting smoking.

9 CHAIRMAN JOHNSON: Senator Diaz.

10 SENATOR DIAZ: We increase taxes to help
11 with the fiscal crisis, but are we increasing tax on
12 cigarette to help people from dying, or to increase --
13 or to help the fiscal crisis? What we using people
14 hurting to increase taxes.

15 MR. CALVIN: I believe that the intent of
16 the legislature in the past has been some of both, and
17 maybe different legislators would answer this
18 differently.

19 The reality that is: If the intent was to
20 get people to quit smoking, increasing the tax would
21 work if the smoking population was a captive audience.

22 SENATOR DIAZ: My question is: We are
23 dealing with the Indian reservation cigarette tax. We
24 need the money. We concentrating on health, whatever.

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1 If people don't die from cigarette, are we going to
2 pursue this or you think that would be a foolish
3 attempt? Do we need the money from the Indian
4 reservation cigarette taxes regardless whatever, or we
5 just doing it to protect people's life?

6 MR. CALVIN: I guess I will leave that to
7 members of the legislature.

8 SENATOR DIAZ: What do you think?

9 MR. CALVIN: I think, Senator, that if
10 there's going to be a high tax it needs to be collected
11 regardless of the motivation for the high tax. If it's
12 going to be on the books, if it's a law, enforce the
13 law. Whatever the intent, whatever the intended result
14 is, follow through and enforce the law.

15 What the reality here in New York is the
16 higher the tax has gone the more people have evaded the
17 tax. So, whatever the intent was, it's defeated. If
18 the intent was to generate a lot more revenue, then you
19 are not going to get the revenue. If the intent was to
20 force people to quit smoking, they are not going to quit
21 smoking.

22 SENATOR DIAZ: We should be concentrating
23 more on raising revenue? We are in deep trouble
24 regardless any other Indian reservation, the cigarette

1 should be taxed regardless whatever. And in the state
2 we need that money, so even though people die or not we
3 should go after that money.

4 MR. CALVIN: I am not sure people would die
5 from the collection of the taxes. If you are asking
6 about our sales of cigarettes --

7 SENATOR DIAZ: I just want to be sure that
8 we are not going into the Indian tax reservation just
9 because we don't want people to die. We don't want
10 people to die, yes, but the main reason we should be
11 taxing, and I am asking you do you believe that it
12 should be taxed regardless, or just going to do it just
13 to help people in the state die less?

14 MR. CALVIN: Die less from smoking, that's
15 what you are referring to?

16 Maybe I can answer the question this way:
17 It comes down to if cigarettes are going to continue to
18 be sold and continued to be consumed by New Yorkers, do
19 you want them to be sold in a retail environment that is
20 licensed, that is regulated and that is taxed, or do you
21 want those cigarettes to be sold in an environment where
22 there are no taxes, are no regulations, are no controls,
23 because that's the direction that we are pushing more
24 and more sales.

1 Right now it's 50 percent and more would go
2 to the tax free side of the street if the tax rate were
3 to increase again without closing off the channels for
4 tax evasion.

5 So, we acknowledge the health risks from
6 smoking. We acknowledge the toll that it takes on
7 smokers and their families and the state budget and so
8 forth, but if there's going to be tax imposed on
9 cigarettes at whatever level, it needs to be enforced
10 fairly and equitably. That's all we're asking.

11 CHAIRMAN JOHNSON: Thank you very much, Mr.
12 Calvin, Mr. Patterson. Thank you very much for your
13 testimony.

14 I am going to invite Sandy Pope, President
15 of Teamsters Local 805, to approach.

16 (SANDY POPE duly sworn.)

17 MR. ADLER: Thank you. Please be seated.

18 Give us your affiliation and office
19 location.

20 MS. POPE: Good afternoon. My name is Sandy
21 Pope. I'm President of Teamsters Local 805 in New York
22 City.

23 CHAIRMAN JOHNSON: Do you have a statement
24 you wish to read?

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1 MS. POPE: Yes, I do.

2 Thank you very much, Senator Johnson and
3 members of the committee.

4 Our union represents over 400 employees of
5 companies that distribute tobacco products in New York
6 State. At one time, that number was well over 3,000.
7 Half the cigarettes in the state are now sold untaxed.
8 According to the wholesalers that I represent, that's
9 \$1.6 billion in lost tax revenues.

10 Members of my local are losing their jobs
11 and the public is facing huge cuts in services,
12 education and jobs. Another side consequence of this
13 situation is the increased violence against drivers
14 because the cost of bootleg cigarettes has gone up as
15 the value of these cigarettes, in a bootleg way, has
16 caused a lot of threats and muggings and people
17 threatened with being shot, things like that.

18 As an advocate for working people all my
19 adult life, I have fought for an even playing field. I
20 want things to be fair. The members of our union have
21 worked hard and received decent wages and benefits to
22 take care of themselves and their families.

23 They have built a health fund that covers
24 their families at relatively low cost for health

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1 insurance, and they have built a pension fund to help
2 support themselves after retirement. We take care of
3 ourselves.

4 Those health and pension funds are now in
5 jeopardy because of the financial difficulties facing

6 our employers and the decreasing number of workers
7 contributing to the fund. Our pension plan currently
8 pays out approximately \$10 million a year to 900
9 retirees of our union. Our ability to continue to pay
10 that money out depends on contributions from active
11 members. If our companies go out of business, our fund
12 collapses and the burden of supporting the retirees will
13 fall to the taxpayers.

14 We pay taxes so our children may attend
15 public schools and universities. We go to the parks and
16 playgrounds. The police and fire departments keep us
17 from harm. And our cars and trucks travel roads paved
18 with our tax money. We depend on the state to collect
19 these taxes and make sure everyone pays their fair
20 share.

21 Again, all we want is an even playing field.
22 We are a relatively small group compared to the many
23 thousands of public employees, our total workers who
24 have been laid off or threatened with layoffs or

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1 cutbacks in hours due to billions in cuts that are
2 proposed by the Governor over the next two years.
3 Again, these cuts are going to also hit middle and low
4 income working families harder than most.

5 That there is this major source of tax
6 revenue uncollected that would go a very long way in
7 reducing cuts is unconscionable. We depend on the state
8 to do their job and collect the taxes that are owed.

9 As a professional negotiator, I know it's
10 hard to work out -- I can't tell you how to do this --
11 all I know is that as a negotiator I know when there is
12 a will there's a way. That's everybody's job to find
13 that way right now.

14 We all need it. I agree with you, Senator,
15 we have to collect the taxes no matter what, regardless
16 of whether there's an impact on people's health or not.
17 That's the law. That's what we have to do.

18 By the way, besides all the non-Native
19 working people and low income people that are going to
20 be terribly hurt by budget cuts, I believe that it will
21 hurt the over 75,000 Native Americans who live and work
22 in New York State as well.

23 Everyone depends on public services.
24 Everyone depends on the public universities, the roads,

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1 the water, the sewer system, etc. Everyone must do
2 their part through taxes to keep our quality of life
3 intact.

4 And I also want to thank Senator Kruger and
5 others who have brought up the issue of the additional
6 taxes being proposed by the Governor. By the way,
7 that's going to kill our companies before you ever start
8 collecting the taxes.

9 Our companies are on the verge of collapse
10 already. I have a number of companies where workers sit

11 around during the middle of the day without work to do.
12 Tuesdays and Wednesdays they are idle. And these
13 companies are still doing the right thing by their
14 workers in staying open, keeping them working even
15 though they don't have enough for 40 hours a week.

16 If this \$10 tax is imposed before they start
17 collecting the taxes, we are dead, we're really dead.
18 And, again, the impact is not just those individual
19 people but their families, the retirees, health plans.
20 There is a huge ripple effect. Just on my small group
21 of 400 workers is enormous.

22 So, the members of Teamsters Local 805 have
23 worked hard to be productive citizens in the State of
24 New York. Our employers do the right thing by us by

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1 negotiating fair contracts so we can have decent wages,
2 health insurance and retirement. All we want is a level
3 playing field.

4 Please represent all of us who depend on the
5 State of New York to apply laws fairly, and continue to
6 provide the services and jobs we need to be a great
7 place to live and work.

8 Thank you.

9 CHAIRMAN JOHNSON: Thank you very much.
10 Anybody have any questions?
11 Thank you very much for your testimony
12 today.

13 Now I am going to call Richard Briffault.

14 (RICHARD BRIFFAULT duly sworn.)

15 MR. ADLER: Please have a seat and tell us
16 your professional affiliation and office address.

17 MR. BRIFFAULT: My name is Richard
18 Briffault. I'm a professor at Columbia Law School in
19 New York City.

20 Mr. Chairman and members of the Committee, I
21 am very honored by your invitation to testify before the
22 committee concerning the legal authority of the state to
23 tax the sale of cigarettes on tribal lands to non-tribe
24 members.

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1 By way of introduction, I am the Joseph P.
2 Chamberlain Professor of Legislation at Columbia Law
3 School, where I am also the Executive Director of the
4 Legislative Drafting Research Fund.

5 Much of my academic career has been focused
6 on state and local government law, the big issues of
7 state and local finance, state constitutional law,
8 federalism, state-local relations, and state and local
9 land use regulations.

10 I am the co-author of a leading state and
11 local government law casebook, as well as more than two
12 dozen law review articles on state and local government
13 law. And last year I chaired the Committee on State and
14 Local Government Law of the Association of American Law
15 Schools.

16 Prior to entering academic life, I was an
17 assistant counsel to Governor Hugh Carey, and while a
18 member of the Columbia faculty, I have worked with a
19 number of New York State commissions.

20 I have been retained by the law firm of
21 Arnold & Porter as an expert on state and local
22 government law in connection with their representation
23 of Altria Client Services and Philip Morris. My
24 testimony and the written memorandum I have submitted to

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1 the committee, and I have additional copies here, and of
2 exhibits that back it up. This memorandum reflects my
3 own research, analysis and conclusions.

4 I'm going to focus my testimony today on
5 three general question: One. What is the nature of
6 Native American sovereignty and how does it affect state
7 taxing power on tribal lands? Two, what is the law
8 governing state taxation of sale of cigarettes by tribal
9 retailers on tribal land to non-tribe members? And
10 three, is this issue in New York affected by the Treaty
11 of Canandaigua of 1794, or the Second Treaty of Buffalo
12 Creek of 1842?

13 My answers in brief are: First, although
14 the term "sovereignty" is often used in discussions of
15 state-tribal relations, Indian tribes or nations are not
16 sovereign in the same sense that foreign nations are.
17 State taxing power with respect to Indian tribes is
18 governed by federal law and by a concern for tribal

19 self-government, but not by sovereignty per se.

20 Second, the United States Supreme Court has
21 repeatedly -- five times -- upheld the authority of the
22 states to tax the sale of cigarettes by tribal retailers
23 operating on tribal lands to non-members of the tribe.
24 A state may impose its tax even if that cuts into tribal

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1 revenues from sales to non-tribe members.

2 And third, neither the Treaty of Canandaigua
3 nor the Second Treaty of Buffalo Creek affect these
4 well-established legal rules. These treaties have no
5 bearing on the authority of the state to impose a
6 cigarette tax.

7 The Buffalo Creek Treaty, in particular, has
8 attracted a lot of attention. But the plain text and
9 history of that treaty indicate that it was intended to
10 bar only taxes and assessments on land, not a tax on
11 sales.

12 If you will permit me, I would like to
13 develop each of these points a little further.

14 On the question of sovereignty, although
15 some early Supreme Court cases spoke broadly of Indian
16 sovereignty, the Court in 1962 explained that "by 1880
17 the Court no longer viewed reservations as distinct
18 nations. On the contrary, it was said that a
19 reservation was in many cases a part of the surrounding
20 state or territory, and subject to its jurisdiction

21 except as forbidden by federal law."

22 As the Supreme Court said in a 1982 case,
23 state-tribal relations are "not controlled by
24 'mechanical or absolute conceptions of state or tribal

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1 sovereignty.'" "

2 Instead of sovereignty, the Court has
3 repeatedly emphasized that issues of state taxing power
4 with respect to Native Americans are to be decided by,
5 one, whether state authority is preempted by federal
6 law; and two, whether state action is inconsistent with
7 tribal self-government, which the Court explained is,
8 "the right of reservation Indians to make their own
9 rules and be governed by them".

10 Again, quoting the 1962 case, "Even on
11 reservations state law may be applied to Indians unless
12 such application would interfere with reservation
13 self-government or impair a right granted or reserved by
14 federal law".

15 In other words, if a state tax or regulation
16 is not preempted by federal law and is not inconsistent
17 with tribal self-government, it can be applied to
18 economic activity on tribal land.

19 Again, as the Supreme Court observed in
20 Nevada v. Hicks, "Our cases make clear that the" -- the
21 decision in 2001 -- "Our cases make clear that the
22 Indians' right to make their own laws and be governed by
23 them does not exclude all state regulatory authority in

24 the reservation. State sovereignty does not end at a

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1 reservation's border. 'Ordinarily' it is now clear, 'an
2 Indian reservation is considered part of the territory
3 of the state.'

4 Turning to the more specific question of the
5 cigarette tax, the Supreme Court has held on five
6 separate occasions that states may impose taxes on the
7 tribal sale of cigarettes to non-tribe members.

8 The specific decisions are the Moe case
9 involving a Montana tax in 1976; the Colville case
10 involving a Washington State tax in 1980; the Chemehuevi
11 case involving a California tax in 1985; the Citizen
12 Band Potawatomi case involving Oklahoma's tax in 1991;
13 and the Milhelm Attea case involving New York's tax in
14 1994.

15 These cases have specifically and repeatedly
16 held that state taxes are not preempted by federal
17 statutes. The Colville case also held that the state
18 taxes were not barred by the treaties invoked by three
19 tribes against Washington State.

20 And the Supreme Court has repeatedly held
21 that state taxation of sales to non-tribe members does
22 "nothing...which frustrates tribal self-government." As
23 the Court put it, "regulation of sales to non-Indians or
24 non-members of the...Tribe simply does not contravene

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1 the principle of tribal self-government."

2 These cases came from five different states
3 and involved a variety of circumstances. Sometimes the
4 tribe was the retailer; sometimes the tax was imposed on
5 tribal retailers operating on tribal land.

6 In the Milhelm Attea case from New York, the
7 burden of tax collection was imposed on wholesalers. In
8 some cases, the tribe also imposed its own tax. None of
9 these differences mattered. In each case, the Supreme
10 Court held that the state could tax sales to non-tribe
11 members.

12 In upholding state taxing authority, the
13 Supreme Court acknowledged but also dismissed the
14 significance of the fact that this would have an impact
15 on tribal finances. As the Court explained in the Moe
16 case, the one involving the Montana tax, "the
17 competitive advantage which the Indian seller doing
18 business on tribal land enjoys over all other cigarette
19 retailers, within and without the reservation, is
20 dependent on the extent to which the non-Indian
21 purchaser is willing to flout his legal obligation to
22 pay the tax."

23 Again, in Colville, the Court acknowledged
24 that the result of applying state taxes "will be to

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1 lessen or eliminate tribal commerce with non-members"
2 but dismissed that concern because "that market existed

3 in the first place only because of a claimed exemption
4 from these very taxes."

5 "Indeed", the Court stressed, again, "it is
6 painfully apparent" -- that's the Court's language --
7 "that the value marketed by the smoke shops to the
8 persons coming from outside is not generated on the
9 reservation by activities in which the tribes have a
10 significant interest" but consists instead "solely as an
11 exemption from state taxation".

12 Again, the Court concluded, "We do not
13 believe that principles of federal Indian Law, whether
14 stated in terms of preemption, tribal self-government or
15 otherwise, authorize Indian tribes thus to market an
16 exemption from state taxation to persons who would
17 normally do their business elsewhere.

18 The courts have upheld a variety of state
19 laws imposing obligations on tribes or tribal retailers
20 in order to enforce the requirement that non-tribe
21 members pay the tax on cigarettes purchased from tribal
22 retailers.

23 Specifically, the Supreme Court has held
24 that states may, one, require tribes or tribal retailers

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1 to collect the sales tax due from non-tribe members and
2 remit it to the state. That occurred in the Moe,
3 Chemehuevi and Citizen Band cases.

4 Two, establish detailed recordkeeping

5 requirements concerning sales to both tribe members and
6 non-members -- upheld in the Colville case.

7 Three, impose a tax on wholesalers, in
8 Milhelm Attea.

9 And four, establish a coupon or quota system
10 to limit the delivery of tax-exempt cigarettes to tribal
11 retailers, again, in Milhelm Attea. In other words, the
12 basic structure of New York's cigarette tax law
13 concerning tribal sales was upheld by the US Supreme
14 Court in Milhelm Attea 16 years ago.

15 One federal court, the United States Court
16 of Appeals for the Sixth Circuit, went even further in
17 its 2007 decision in Keweenaw Bay Indian Community v.
18 Rising. In that case, the court held that the State of
19 Michigan could require tribal retailers to prepay the
20 cigarette tax with respect to all tobacco products,
21 including products sold to tribe members, with the state
22 subsequently refunding a portion of the tax attributable
23 to tax-exempt sales.

24 The courts have also held that there are a

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1 variety of mechanisms to enforce these requirements.
2 Although the Supreme Court in Citizen Band concluded
3 that a state could not sue a tribe directly for payment
4 of unpaid taxes, the Court emphasized there are many
5 "adequate alternatives" by which the state can enforce
6 its tax laws.

7 The Court gave as illustrations of state

8 enforcement power: State actions for damages against
9 individual agents or officers of a tribe; collection of
10 the sales tax from cigarette wholesalers; seizing
11 unstamped cigarettes off the reservation; assessing
12 wholesalers who supply unstamped cigarettes to tribal
13 stores; and entering into legally enforceable
14 agreements, or compacts, with the tribes. This list is
15 not meant to be an exhaustive list, and there may be
16 other mechanisms.

17 Turning finally to the treaties, on several
18 occasions in recent years the Seneca Nation has
19 contended that the application of New York's cigarette
20 tax laws to transactions on Seneca tribal lands would
21 violate treaties between the Seneca Nation and the
22 United States.

23 The Seneca have focused on two treaties in
24 particular, the Treaty of November 11, 1794, generally

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1 known as the Treaty of the Six Nations or the Treaty of
2 Canandaigua, and the Treaty with the Seneca, May 20,
3 1842, also known as the Second Treaty of Buffalo Creek.
4 Neither treaty has any application to the cigarette tax
5 question.

6 The principal relevant provision of the
7 Treaty of Canandaigua, Article 3, simply acknowledges
8 certain lands as "the property of the Seneca Nation",
9 with the United States pledging it "will never claim the

10 same, nor disturb the Seneca Nation, nor any of the Six
11 Nations, or of their Indian friends residing thereon and
12 united with them, in the free use and enjoyment
13 thereof." Probably the critical language, "in the free
14 use and enjoyment thereof."

15 As the Supreme Court has explained, this
16 treaty was "one of peace and friendship between the
17 United States and the Indians." The treaty does not
18 directly address the question of taxation at all.

19 Federal courts have repeatedly rejected
20 arguments that the Treaty bars the application of the
21 income tax to residents of treaty lands, or the
22 application of excise taxes to transactions on treaty
23 lands.

24 The United States Court of Appeals for the

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1 Third Circuit found that the "free use and enjoyment"
2 language might bar a tax on income derived directly from
3 the land, but not other income.

4 The United States Court of Appeals for the
5 Federal Circuit held that the Treaty has no application
6 to a sales or excise tax, which, as the Court explained,
7 "is a tax on the sale of a commodity".

8 Turning to the 1842 Treaty of Buffalo Creek,
9 also known as the Second Treaty of Buffalo Creek, that
10 does address state taxation, but it is concerned solely
11 with taxes on land. Key provision there is in Article
12 Ninth.

13 Here "the parties to this compact mutually
14 agree to solicit the influence of the government of the
15 United States to protect such of the lands of the Seneca
16 Indians, within the State of New York, as may from time
17 to time remain in their possession from all taxes, and
18 assessments for roads, highways, or any other purposes
19 until such lands shall be sold and conveyed by the said
20 Indians, and the possession thereof shall have been
21 relinquished by them."

22 The Treaty's textual focus on taxes on land
23 and assessments against land is explained and reinforced
24 by the Treaty's history. In 1838, that is four years

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1 before this treaty, the Seneca, by a different treaty,
2 agreed to removal to west of the Mississippi within five
3 years following the proclamation of that 1838 treaty by
4 the President of the United States.

5 In that same treaty, they also conveyed
6 their lands to certain white purchasers subject to their
7 right to remain before removal. The Treaty of 1842
8 scrapped the removal plan, confirmed the Indians'
9 reservation rights, and cancelled the conveyance.

10 But in the meantime, between 1838 and 1842,
11 the state legislature authorized, and the counties of
12 Allegany, Cattaraugus, and Erie imposed, assessments on
13 the Seneca lands to fund construction and repair of
14 highways, roads and bridges on those lands.

15 The assessment of legislation provided for
16 state acquisition and sale of the lands in the event of
17 non-payment of the assessments, subject to the Indians'
18 right to occupy the lands.

19 When highway assessments and ordinary town
20 and county taxes for 1840, 1841, 1842 and 1843 were not
21 paid, the lands were sold, subject to the Indian right
22 of occupancy. Subsequently, in 1857, the state
23 legislature repealed the taxes and barred the assessment
24 of taxes on Indian reservation lands. In 1866, the US

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1 Supreme Court invalidated the assessments.

2 This history, which is chronicled by the
3 Supreme Court in that 1866 case, known as *In re: New*
4 *York Indians*, explains the very specific reference to
5 "assessments for roads, highways, and other purposes" in
6 Article 9 of the Treaty of Buffalo Creek. It
7 demonstrates that the Treaty's concern was with taxes
8 and assessments on land of the kind that led to the
9 forfeiture of tribal land.

10 This was the conclusion that's been reached
11 by the Appellate Division for the Fourth Department in
12 1993 in the case of *Snyder v. Wetzler*; by that same
13 court again in 1997 in *State Department of Tax and*
14 *Finance v. Bramhall*; and by the US Court of Appeals for
15 the Second Circuit in 2007 in *United States v. Kaid*.

16 The Solicitor General of the United States
17 has also concluded that the Second Treaty of Buffalo

18 Creek "is limited to taxes assessed against the land
19 itself".

20 Indian treaties do not operate as external
21 constraints on the law. Instead, they are part of the
22 body of federal law that the courts examine and construe
23 when they determine whether or not state regulations or
24 state taxes are preempted. The courts regularly

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1 interpret Indian treaties.

2 The Colville decision, upholding Washington
3 State's taxation of the tribal sale of cigarettes to
4 non-tribe members, turned in part on the interpretation
5 of three Indian treaties. To be sure, the courts have
6 generally held that "treaties should be construed
7 liberally in favor of the Indians", but even the rule of
8 liberal construction may be inadequate to save a tribal
9 claim. This is particularly true for tax exemptions.

10 As the US Court of Appeals for the Ninth
11 Circuit explained, "Although ambiguous statutes and
12 treaties are to be construed in favor of Indians, they
13 are not to be construed to grant tax exemptions unless
14 they contain language which can be reasonably so
15 construed."

16 The United States Supreme Court said it
17 conclusively in Oregon Department of Fish and Wildlife
18 v. Klamath Indian Tribe in 1985: "Even though 'legal
19 ambiguities are to be resolved in favor of the

20 Indians'...courts cannot ignore plain language that,
21 viewed in historical context and given a 'fair
22 appraisal'...clearly runs counter to a tribe's later
23 claims".

24 The "plain language" of the text of the

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1 Treaty of Buffalo Creek provides an exemption only for
2 taxes and assessments on land. That reading of the
3 plain language, in turn, is confirmed by the "historical
4 context" which demonstrates that Article 9 of the Treaty
5 was motivated by the specific experience of the county
6 imposition of highway, road, and bridge assessments on
7 Seneca lands in the years right before that treaty.

8 The treaty was plainly intended to prevent
9 recurrence of assessments on land. But it says nothing
10 about and has no bearing on a sales tax, which is not a
11 tax on land.

12 Thank you for the opportunity for speaking
13 here today. I would be happy to answer any questions
14 you have.

15 CHAIRMAN JOHNSON: Thank you very much,
16 Professor. I appreciate the very thorough testimony
17 walk through and the exhibits you provided.

18 I am sure your testimony addressed this, get
19 a little more clarification. I don't believe you
20 attended the hearing on October 27th; is that correct?

21 MR. BRIFFAULT: I did not, no.

22 CHAIRMAN JOHNSON: At the hearing on October

23 27th we heard testimony from the Seneca Nation and their
24 representative -- what was very interesting -- about

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1 their dispute as to Buffalo Creek and the six nation
2 treaties, but what was I think very compelling, very
3 interesting, is: At one point during the testimony,
4 testimony was given in connection with interpretations
5 and the nation being sovereign nations.

6 Reading directly from the transcript. "Your
7 court cases are meaningless to us and do not bind our
8 conduct". That was testimony given by representatives
9 of the Seneca nation.

10 Maybe you can clarify. Are these cases
11 binding on the nations, and if so, can you maybe
12 indicate, first of all, federalism and how they do have
13 such authority on the nation.

14 MR. BRIFFAULT: They are binding. The short
15 answer is they are binding. They have been -- federal
16 court interpretations of Indian treaties have been
17 treated as binding on the parties to them, including
18 both the federal government, when that comes up, states
19 that are affected by them, and Indian nations, Indian
20 tribal members, for several hundred years.

21 So, they have been treated as binding. I
22 think a lot comes up on this very difficult question of
23 what is the legal status of the Indian tribes and Indian
24 nations that I think we, as a country, have struggled

1 with that and the courts have struggled with that going
2 back to almost the beginning of the country.

3 And the view today, the law today is, and
4 for quite a long time is that the Indian nations are not
5 sovereign in the same sense as foreign nations are
6 sovereign. That is, important history and tradition
7 have taken into account there's an important federal
8 interest in protecting tribal self-government, but
9 there's not that kind of independence that we associate
10 with the sovereignty of foreign nations.

11 They are part of the United States and
12 federal court interpretation. The treaties in this
13 sense are treated akin to federal statute. So, they are
14 regularly interpreted and applied.

15 The Colville case, which I mentioned, which
16 was the second in the sequence of Supreme Court cases,
17 dealing with state taxation, cigarette sales to
18 non-tribe members, involved the reading of -- Supreme
19 Court's reading of treaties in 1855. The treaties had
20 been interpreted and applied, treated as binding law.

21 CHAIRMAN JOHNSON: Now, I also understand,
22 though, with respect to the two cases of Buffalo Creek
23 that the Seneca Nation itself was not an actual party to
24 the case; is that correct?

1 MR. BRIFFAULT: Certainly they were not a

2 party to the Milhelm Attea case. They raised this
3 argument in an amicus brief in that case.

4 I'm not a hundred percent sure about the
5 other one. I know in the Kaid case it was a cigarette
6 contraband trafficking case in which the defendant was
7 saying it was not a valid law, but the federal court
8 upheld it, but I'm not sure, no.

9 CHAIRMAN JOHNSON: Now, Native American
10 tribes have their own court system; is that correct?

11 MR. BRIFFAULT: Uh-huh.

12 CHAIRMAN JOHNSON: Do they -- does the
13 Native American court system have the authority to
14 interpret a treaty or is that a power vested with the
15 federal government, with the federal court --

16 MR. BRIFFAULT: They certainly -- they do.
17 They certainly have the authority to apply laws within
18 the system and make decisions within the tribes,
19 governing tribal members. Part of the issue that's come
20 up, obviously in the context of cigarette sales, is
21 we're talking about the relationship between the tribe
22 and non-tribe members.

23 The Supreme Court has said that that's the
24 crucial distinction. The very first case said the state

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1 could not tax tribal sales to tribal members. That is
2 dealing solely with this core area of tribal
3 self-government.

4 What the court had said is that once we
5 begin to get into the other area of relationships with
6 non-tribe members it's different and it's not in the
7 core.

8 I mean the language that the Supreme Court
9 uses is particularized inquiry. Federal interest, state
10 interest, tribal interest shifts depending on the nature
11 of the situation; whereas the tribes' sale to non-tribe
12 members is different. It doesn't fall within that core.

13 CHAIRMAN JOHNSON: There was also testimony
14 at the prior hearing that if there's -- and I think you
15 hit upon this -- if there is a dispute between one of
16 the Native American nations and New York State with
17 respect to this particular issue it should be because
18 Native Americans are a foreign nation and then the
19 dispute should go to the United Nations.

20 Is that an accurate...

21 MR. BRIFFAULT: It's not the law. There
22 have been disputes between Indian nations and states
23 going back to the 19th century. They have been handled
24 in American domestic courts, federal courts. It's not

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1 the law.

2 CHAIRMAN JOHNSON: Senator Klein.

3 SENATOR KLEIN: Thank you for testifying,
4 Professor.

5 You talked about earlier that other states
6 have compacts with their Native American natives. Can

7 you tell us about what they entail? Is it a tax? It is
8 money that's dedicated to certain areas?

9 MR. BRIFFAULT: I haven't spent a lot of
10 time on it, most of my research was focused on the case
11 law, Supreme Court and Federal Court case law, but
12 sometimes those compacts could be mentioned in the
13 course of it.

14 So, I know for sure there's some elements of
15 revenue splitting in terms of whether those compacts or
16 agreements, in turn, focus on how the revenues are
17 distributed, that I'm not sure about, but I know that
18 there are provisions that deal with elements of
19 splitting of the revenue.

20 SENATOR KLEIN: You are certainly very, very
21 knowledgeable about the case law and legal argument in
22 other states. Has the same type of issue happened and
23 been resolved in other states? I mean, this has been
24 going on in New York State for the longest time and made

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1 itself very, very clear by citing many seminal cases in
2 this area that it's clear that Native Americans do not
3 have the right to -- I should say the state government
4 doesn't have the right to tax real property and that's
5 where it ends.

6 Has this issue been resolved in other states
7 where other states are actually now going in and
8 collecting the tax?

9 MR. BRIFFAULT: I can speak more to whether
10 it's been legally resolved rather than how it's been
11 resolved politically in its practice. Indeed, there
12 continue to be disputes.

13 I mentioned that the Michigan case in 2007,
14 State of Michigan felt that it had to take a pretty
15 strong step. A very recent case in Washington State
16 again. What you are describing is every time one of
17 these things gets to court the legal resolution is
18 always the same, that there's a reaffirmation of state
19 power here; there's a review of the kind of mechanism
20 being used and usually that mechanism has been uphold,
21 particularly if the court looks at the context and finds
22 that there has not been cooperation and often been
23 willing to upheld stronger measures.

24 MR. KLEIN: I guess what I'm getting at is:

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1 Ultimate resolutions, some type of agreement, some type
2 of settlement. Again, what I am getting at is in New
3 York you cite all these cases. I have certainly read
4 the seminal case. Milhelm Attea was actually argued by
5 a former Attorney General here in New York.

6 At the same time, what we seem to find every
7 time a court, once again, says we have the right to
8 collect this tax, unfortunately the response from a lot
9 of Native American tribes say, hey, you know, it's not
10 up to us and, unfortunately, violence is threatened.

11 What are the cases in other states? Are the

12 resolutions similar?

13 MR. BRIFFAULT: As often happens, when
14 things actually get resolved they don't show up in
15 cases. The cases tend to be the situations where --

16 SENATOR KLEIN: I guess what I'm asking is
17 after the dust settles, the legal decision, what is the
18 ultimate resolution.

19 MR. BRIFFAULT: To be honest, I don't fully
20 know the answer to that. I know that in some states
21 these things have been resolved by compacts. Compacts
22 do last at least for awhile and sometimes there are
23 problems with the compact, but compacts do exist.

24 SENATOR KLEIN: Thank you.

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1 CHAIRMAN JOHNSON: Senator Nozzolio.

2 SENATOR NOZZOLIO: Thank you, Professor, for
3 your assessment and review of this very important
4 matter. I believe what we all want to achieve is a
5 permanent resolution in these matters.

6 I would like to focus attention of you on
7 New York and whether or not, as you indicate, the
8 treaties that have been reviewed by you and others.
9 Let's start from this point of view.

10 The state's power to tax, in your opinion,
11 is generally preempted by federal treaty. In most cases
12 when it is preempted it's preempted by federal treaty;
13 is that not true?

14 MR. BRIFFAULT: Let me rephrase that
15 slightly, which is the state's power to tax is subject
16 to federal law in the area. It could be a federal
17 statute. It could be a treaty. Depends on exactly what
18 the statute or the treaty says.

19 Sometimes the courts have said certain kinds
20 of taxes are preempted by federal statute or by treaty
21 and sometimes they said certain type of taxes are not.

22 SENATOR NOZZOLIO: Senators Klein and
23 Johnson had asked you questions about state agreements
24 and state decisions within that context.

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1 In New York, we still have issues of
2 treaties that need to be analyzed and understood. You
3 are extremely definitive in your analysis about the fact
4 that the Treaty of Buffalo Creek, Second Treaty of
5 Buffalo Creek, does not apply to retail transactions.

6 How can you be so definitive?

7 MR. BRIFFAULT: It's a fair point. I mean
8 in some ways we have not had a final US Supreme Court
9 resolution on this. What I am relying on partly is the
10 text. A lot of the history, particularly if you look at
11 the background of the negotiations of that treaty,
12 really, the problem it was addressing was the problem of
13 assessments designed to fund improvements to land.

14 And the three court decisions, which are not
15 the United States Court decision, that's fair, but the
16 three cases that have actually given it some attention,

17 which all read the same, the background the same way, as
18 well as statements of the Solicitor General of the
19 United States in an amicus brief in the Milhelm Attea
20 case, which was not used by the court but the court does
21 cite to it on the treaty point.

22 So, you are right, there has been no
23 definitive ultimate resolution by the Supreme Court, but
24 there are these other materials which I think are very

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1 helpful.

2 SENATOR NOZZOLIO: I have been analyzing
3 this treaty since our last hearing, because the points
4 were raised very strongly that this treaty, in view of
5 many, has exempted the Senecas from taxation.

6 I guess in looking at the context of this,
7 how many other areas of taxation existed during the
8 1840s that, in putting this language in context, what
9 other taxes were there besides land taxes?

10 MR. BRIFFAULT: I think there were excise
11 taxes in the 19th century. There were taxes on liquor,
12 for example, Whiskey Rebellion. I think there were --
13 income taxes probably didn't exist around the time of
14 this treaty, but I think there were excise or sales
15 taxes that did exist then.

16 SENATOR NOZZOLIO: But probably not sales
17 and general commerce. Probably product specific sales.

18 MR. BRIFFAULT: I would have to research

19 that.

20 SENATOR NOZZOLIO: I guess that's what I am
21 struggling with in terms of looking at this: What was
22 really the context at the time? I mean the obvious
23 reading is not necessarily the accurate reading here,
24 and the issues of land certainly was perceived, but was

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1 really these other taxes appropriate to this analysis.

2 That's what I would welcome your comments.

3 MR. BRIFFAULT: I am not sure I have much to
4 add. I think you raised some legitimate points. It
5 seems partly it's the language, but also I think the
6 history of how the treaty came to be, what the problem
7 was.

8 Often in issues of statutory interpretation,
9 treaty interpretation, the phrase is sometimes used
10 what's the mischief to be remedied, what was the problem
11 that document, that the law was designed to address.

12 And it seemed to me that, as recounted by
13 the US Supreme Court just 20 years after the treaty was
14 signed, it was this very specific situation of
15 assessments being imposed on lands, on Seneca lands, in
16 those three counties.

17 Sometimes the assessments and other land
18 taxes not being paid, properties are being foreclosed
19 upon and sold. It seems to me it was very much
20 responsive to a specific problem.

21 SENATOR NOZZOLIO: Thank you, Mr. Chairman.

22 CHAIRMAN JOHNSON: Thank you very much for
23 your time today.

24 Now I'm going to call before us Jose Luis

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1 Murillo for testimony.

2 (JOSE LUIS MURILLO duly sworn.)

3 MR. ADLER: Please state your name, your
4 affiliation and office address. We would appreciate it.
5 Thank you.

6 MR. MURILLO: Thank you very much. My name
7 is Joe Murillo. I'm from Altria Client Services.
8 Office address is 6601 West Broad Street in Richmond,
9 Virginia.

10 I'm here today on behalf of Philip Morris
11 USA, which is the largest manufacturer of cigarettes in
12 the United States. With me is Chuck Curtis, a partner
13 in the law firm of Arnold & Porter, who represents our
14 company in these matters, and is here to help me with
15 any questions the committee may have.

16 For example, Senator Klein, I know that Mr.
17 Curtis has gone through some of the compact. So,
18 perhaps we might be of help with that question as well.

19 My job includes oversight of our brand
20 integrity department, a department formed about seven
21 years ago as part of our ongoing efforts to protect the
22 integrity of our companies' brands.

23 For many years we have worked with

24 legislatures, law enforcement authorities, policymakers,

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1 wholesalers, retailers, and a range of others to help
2 reduce the incidence of contraband cigarettes.

3 We do this because we have a real stake in
4 this issue. Our brands are very important assets to our
5 company. We invest heavily in them and the legitimate
6 trade channels through which our products are sold.

7 Contraband activity represents a very
8 significant threat to these investments. Trafficking in
9 counterfeit cigarettes is a criminal activity that
10 directly harms our trademarks. Other illegal activity,
11 such as diversion of cigarettes to evade taxes, can
12 seriously undermine confidence in the distribution
13 chain.

14 But, the fact is that all New Yorkers have a
15 significant interest in seeing contraband cigarette
16 activity stopped.

17 There is little doubt that the state's
18 practice of allowing wholesalers to sell unlimited
19 quantities of untaxed cigarettes to tribal outlets
20 contributes significantly to downstream contraband
21 activity.

22 Today, New York allows about 175 tribal
23 outlets, out of a total of about 23,000 retail outlets,
24 to purchase untaxed cigarettes from non-tribal

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1 wholesalers and then resell that product -- tax free --
2 to non-tribal consumers.

3 I have brought a demonstrative exhibit that
4 shows in the form of a pie chart the 175 retail outlets
5 account for about 0.8 percent of the retail stores
6 versus the 23,000 non-reservation retail outlets.

7 As the excise tax rate in New York has risen
8 over time, selective tax enforcement has resulted in
9 this small subset of outlets to now account for nearly
10 one-third of all the cigarettes sold in the State of New
11 York.

12 To put this in perspective, in 2008, these
13 175 outlets sold more than 274 million packs of
14 cigarettes. That's more cigarettes than were sold in
15 the entire State of New Jersey for that year.

16 The costs associated with the forbearance
17 policy of non-enforcement are well known.

18 First, the state loses enormous amounts of
19 revenue. Estimates vary, but it seems quite clear that
20 if the state were to close this loophole and require all
21 cigarette volume destined for New York consumers to be
22 taxed, the state, at the very least, would gain hundreds
23 of millions of dollars in revenue.

24 But lost revenues are not the only issue.

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1 This policy is unfair to the wholesalers and retailers
2 who are required to sell only tax-paid product. We work

3 every day with New York retailers and wholesalers. We
4 know the challenges that they face in an increasingly
5 competitive environment.

6 Ending selective tax collection would shift
7 the sales back to these businesses, providing them
8 much-needed relief at a time when they need it most.

9 In addition, selective tax collection
10 contributes to downstream illegal conduct. This illegal
11 conduct takes many different forms, as illustrated by
12 the numerous law enforcement investigations that we
13 support, that are described in my written submission.

14 One form of tax-evading activity is the sale
15 of untaxed product via the Internet to consumers both
16 inside and outside of New York. While New York has
17 banned the sale of cigarettes to consumers in the state
18 via the internet, it does not appear that this law is
19 being enforced either.

20 In fact, our data indicates that New Yorkers
21 buy 20 percent of all cigarettes sold over the Internet.
22 This is far more than any other state.

23 The lack of enforcement of this Internet law
24 is one reason that New York has become the internet

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1 cigarette capital for US cigarette purchasers. As of
2 2008, nine out of the top ten Internet sites selling
3 untaxed cigarettes were based in New York.

4 In addition to internet sales, the state's
5 non-enforcement policy has contributed to the growth of

6 reservation outlets that essentially act as bulk
7 resellers of untaxed cigarettes.

8 These outlets purchase large quantities of
9 untaxed cigarettes from non-tribal wholesalers, and then
10 resell them in large quantities to non-tribal
11 purchasers. The non-tribal purchasers, in turn,
12 transport the untaxed cigarettes to other locations off
13 reservation, like street corners or subway cars, where
14 they are sold untaxed.

15 There are about 20 such outlets located on
16 the Poospatuck Reservation, an area occupying about 55
17 acres in Mastic, Long Island. These 20 outlets account
18 for sales in excess of 800,000 packs of cigarettes each
19 week.

20 That translates to more than 40 million
21 packs per year. To put this number in perspective, more
22 cigarettes are sold annually on the Poospatuck
23 Reservation than sold in the entire state of Vermont.

24 The issues in Mastic are not limited to tax

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1 evasion. Indeed, we have brought numerous lawsuits,
2 including one filed just this past Friday, against
3 Poospatuck smoke shops that we discovered were selling
4 counterfeit Marlboro cigarettes.

5 There is no question in our minds that high
6 taxes, coupled with selective tax collection, have
7 fostered a range of illegal activity, including

8 counterfeiting. Clearly, this situation is
9 unsustainable.

10 We recognize that Indian Nations with
11 reservation lands in New York have a legitimate concern
12 that these matters be resolved in a way that respects
13 tribal sovereignty and federal treaties. Federally
14 recognized Indian Nations enjoy the right to sell
15 cigarettes to their tribal members free of state tax.

16 But, to be clear, the state is fully
17 authorized to collect the tax on the sale of products to
18 New York consumers, whether those products originate
19 from another state, another country, or from a
20 reservation.

21 We believe that New York has a variety of
22 options available to begin collecting tax on the stream
23 of commerce immediately. A number of options are
24 described in my written submission.

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1 While we are encouraged by the Governor's
2 announcement that he intends to enforce the law and
3 collect these excise taxes, the time to do so is now.
4 And I would urge both the legislature and the
5 administration to impose a date certain by which these
6 taxes will be collected.

7 New York can no longer afford to ignore the
8 laws on the books and allow a subset of outlets to drain
9 so large a percentage of tax revenues. The problems
10 associated with contraband cigarette sales and the

11 uncollected tax revenue will grow only more profound the
12 longer we wait to act.

13 I acknowledge the leadership of Chairman
14 Johnson and the members of the committee to bring this
15 important matter to everyone's attention. And thank you
16 very much for the opportunity to participate. Be happy
17 to take any questions you have.

18 CHAIRMAN JOHNSON: I just have a couple of
19 quick questions and Senator Klein does.

20 How significant is the sale of counterfeit
21 cigarettes, counterfeit Altria cigarettes, on the Native
22 American reservation lands through smoke shops? What's
23 the economic bottom line, financial bottom line for the
24 company?

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1 MR. MURILLO: For our company it's
2 devastating because for each pack of counterfeit
3 cigarettes that is a complete pack of revenue that we
4 are not getting and, of course, it would be over half of
5 that revenue that goes to federal and state government
6 also not being collected.

7 So, of the 20 smoke shops in the Poospatuck
8 area in Long Island, we have sued at least five,
9 possibly more, over the last few months for selling
10 counterfeit Marlboro cigarettes. Without a doubt since
11 the tax increases we have seen an increase in
12 counterfeiting of Marlboro products.

13 SENATOR KLEIN: Stamped counterfeit or the
14 actual product?

15 MR. MURILLO: Both, Senator. We find
16 product that is counterfeited that has a legitimate
17 stamp. We find product that is counterfeited that has
18 no stamp because the product that is flowing through the
19 tribal shops doesn't have a stamp, and that's part of
20 what facilitates the activity, in our opinion.

21 CHAIRMAN JOHNSON: Change the topic. We are
22 now not in October anymore but we're in January.

23 The Governor's proposal for a one dollar tax
24 increase, if that happens, do you see -- this is a

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1 loaded softball for you so go ahead and hit it out of
2 the park -- do you see an increase in the sale more of
3 unlicensed cigarettes and what do you think you can do
4 to stop it?

5 MR. MURILLO: Well, thank you for the
6 question, Senator. Imagine a bucket that you are trying
7 to fill with water and the water is the excise tax
8 collection that's coming in, and at the bottom of the
9 bucket you have at least a 30 percent hole, so a third
10 of your bucket has a hole and the water is seeping
11 through the other side and you are not collecting the
12 water in that bucket. It would seem to me that's what
13 you want to do is plug the hole, i.e., collect the tax.

14 The only thing that you do, if you take your
15 spigot of your water that's going into that bucket and

16 put more water pressure through the bucket, is lose more
17 money.

18 So, absolutely, we urge the administration
19 to collect the tax and see that revenue now before
20 considering any further tax increase.

21 CHAIRMAN JOHNSON: Senator Klein.

22 SENATOR KLEIN: I want to thank you,
23 Chairman Johnson.

24 I want to thank you because, when I wrote

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1 the law which banned the sale of cigarettes over the
2 Internet, Altria was very, very helpful. Some of the
3 other companies weren't as helpful.

4 I guess my question leading into that is:
5 Are there any other states that have passed a similar
6 law to the one that I passed which bans the sale of
7 cigarettes over the Internet through mail order?

8 MR. MURILLO: Yes. I can't quote you the
9 number right now. I believe a number of states have
10 passed similar bans.

11 SENATOR KLEIN: My next question: Have they
12 been successful in enforcement? Because clearly we have
13 not been successful in enforcement.

14 MR. MURILLO: They have enforcement in a
15 number of states. I have not seen any evidence of
16 enforcement of 1399L in New York.

17 SENATOR KLEIN: The reason why is that one

18 of the things that we have been able to convince common
19 carriers like Federal Express not to deliver the
20 cigarettes. Of course, now they are being delivered
21 through the United States Postal Service.

22 So, I would be very curious on how these
23 other states were regulating Postal Service which we
24 have no jurisdiction over.

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1 MR. MURILLO: Right. Certainly, some states
2 have chosen to have a complete ban, delivery, sale ban,
3 so, in other words, it becomes illegal for cigarettes to
4 be delivered to consumers into those states, which is
5 similar to an aspect of New York law.

6 In addition, a number of states have similar
7 compacts with common carriers that require either that
8 they not carry the product or try to have an assurance
9 of tax payment and age verification both at the point of
10 purchase and the point of delivery.

11 There is a federal law pending in Congress
12 which I would direct your attention to, and we support,
13 called Pat tax and the Pat tax would make cigarettes
14 non-mailable by the Post Service so that that issue
15 would end.

16 SENATOR KLEIN: My next question is:
17 Clearly, Altria is by far the largest share of the
18 market, specifically with your product Marlboro. How
19 would you take, I guess, the company take a leading role
20 in just not selling cigarettes to manufacturers who are

21 selling to Native American reservations without a stamp?

22 I mean you seem to have a pretty good handle
23 on the amount of untaxed cigarettes that are out there.
24 I'm sure you could figure out in a second which of the

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1 wholesalers that I believe are illegally selling these
2 cigarettes to Native American tribes because they are
3 not fixing a tax stamp on them.

4 MR. MURILLO: The best way to answer that
5 question is with a diversion into history. In essence,
6 we have tried that. In response to inquiries from the
7 Attorney General several administrations ago, we agreed
8 to not sell cigarettes to wholesalers unless they either
9 produce an approval of some sort from the Attorney
10 General that the commerce was legal or could otherwise
11 satisfy that that commerce was legal because the
12 Attorney General said that, in fact, it was not legal.

13 That was met with almost instant litigation,
14 and the Attorney General was, in essence, enjoined from
15 requiring us or persuading us not to sell to
16 wholesalers. I think that's an example of how we've
17 tried a number of things and unilateral action has not
18 thus far been successful.

19 We think that the best course of action is
20 for the law to be enforced. Once the coupons are
21 issued, once the law of New York is enforced, then there
22 is no possibility for anyone to argue that there is some

23 confusion over whether the law is in effect or it's
24 being enforced.

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1 SENATOR KLEIN: I guess, you know, you hear
2 about the threat of bloodshed and was something that
3 occurred back in '96 when then Governor Pataki attempted
4 to enforce the tax laws.

5 I guess to prevent that, to prevent anybody
6 from stepping foot on a Native American reservation to
7 enforce the rules, can we just turn around and say,
8 okay, this is a wholesaler that is selling untaxed
9 cigarettes and not affixing the stamp, we will take away
10 your license. The State of New York is taking away your
11 license, your ability to sell cigarettes.

12 Isn't that an enforcement mechanism in that
13 Philip Morris can turn around, and Altria, and say, hey,
14 you don't have a state license to sell cigarettes. The
15 cigarette supply has just dried up.

16 MR. MURILLO: Absolutely, and I think the
17 issue of violence and civil unrest is without a doubt
18 very provocative and certainly is something that
19 everyone would do everything possible to avoid.

20 I think there's a little bit of a myth, if
21 you will, about the concept of having to go on to a
22 tribal reservation to enforce the law. I think, as we
23 have heard repeatedly today and at the last hearing,
24 there are tribal governments and they do what they need

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1 to do to function as governments for the nations.

2 I think what you say about wholesalers is
3 correct. We don't have to go or no one -- New York
4 State doesn't have to go on to tribal reservations, as
5 far as I can tell, to collect the tax.

6 The sole function of wholesalers under New
7 York law is to collect the tax. That's what they are
8 supposed to do. So, the licensing and the stamping
9 regime in New York is designed to make sure that the
10 wholesalers are collecting the tax and providing the
11 information that is necessary to back that up.

12 So, the people who need to abide by the tax
13 collection law are the wholesalers, and then of course
14 retailers will be receiving stamped product. We will
15 know what's going on as a manufacturer vis-a-vis our
16 wholesaler customers, but that's really where the
17 enforcement is intended to be focused is on the
18 wholesalers.

19 CHAIRMAN JOHNSON: Senator Nozzolio,
20 anything?

21 SENATOR NOZZOLIO: Thank you.

22 CHAIRMAN JOHNSON: Thank you very much,
23 gentlemen. Appreciate your time.

24 The last witness to testify today is Mariam

1 Ozaltin.

2 (MARIAM OZALTIN duly sworn.)

3 MR. ADLER: Please have a seat and tell us
4 your affiliation and office address.

5 MS. OZALTIN: Good afternoon, ladies and
6 gentlemen, Chairman Johnson and distinguished members of
7 the committee. My name is Mariam Ozaltin and I am the
8 Government Affairs Coordinator at SICPA Product Security
9 in New York. SICPA is the world's leading security
10 agent and integrated security solutions provider.

11 Thank you for the opportunity to provide
12 testimony today that might assist you in the great
13 challenge that lies ahead. I'm here today to tell you
14 that New York has an alternative way to effectively
15 capture vital tax revenues that are so badly needed.

16 In an effort to close the \$1.3 billion
17 budget deficit, New York legislative leaders are
18 discussing numerous solutions for collecting tobacco
19 taxes and are struggling with the ongoing issue of tax
20 free sales on Indian reservations and over the internet
21 non-Native Americans.

22 We recommend New York to look elsewhere to
23 enhance the capabilities of tax collection, compliance
24 and enforcement by securing legitimate tobacco sales

1 with an encrypted stamping program.

2 The program would establish the use of a
3 secure tax stamp, leveraging the same multi-layered
4 security approach used to protect the US dollar and

5 other currencies around the world today.

6 The highly secure tax stamp incorporates
7 both overt or visible security features, and covert or
8 invisible security features on to the stamp. Encoding
9 the stamp with unique encrypted information allows the
10 government to efficiently collect taxes while helping
11 law enforcement to pinpoint the product origins.

12 It can include information, such as the date
13 the stamp was affixed, the name and distributor affixing
14 the stamp, the manufacturer of the cigarettes, etc.

15 The currently applied tax stamp used in New
16 York is based upon an antiquated 50 year old technology
17 that is unable to incorporate modern technologies that
18 law enforcement officials require to effectively combat
19 illegal sales of cigarettes.

20 New technology integrating these security
21 features features enforcement devices and enforcement
22 technology systems that enable law enforcement
23 professionals to track cigarette shipments. They also
24 track the point of departure from legitimate supply

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1 chain and help stop the black market cigarette trade
2 that threaten's the state excise tax revenue flow, as
3 well as the safety and security of New York's residents.

4 Technology exists today that can detect the
5 presence of illegitimate products within the legitimate
6 commerce channel while also enhancing the state's

7 ability to more effectively promote legitimate sales and
8 collect excise taxes associated with legitimate tobacco
9 products.

10 Companies such as SICPA use cutting edge
11 technology to enable stocking and tracing of cigarettes
12 in real time through the supply chain and we offer
13 systems in both state and federal jurisdiction.

14 A new stamping system can also help recover
15 the loss of almost 50 percent of business and several
16 independent studies strongly point to diverse levels
17 approaching hundreds of millions of dollars per year.

18 Legislation would provide an encrypted stamp
19 program system which has already been introduced in New
20 York by Senator Stachowski, who stepped out, and the
21 bill is pending in your committee, Chairman.

22 Groups including NYPIRG, the New York State
23 Association of Counties, the American Cancer Society,
24 American Heart Association, American Lung Association of

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1 New York State, and the Campaign for Tobacco Free Kids,
2 that will all make a case for high tech tax stamps.
3 Such wide support cannot be seen alone when taking up
4 issues with Indian sales.

5 Resistant time stamps are part of a combined
6 approach for revenue collection and reduction of illicit
7 trade. An encrypted stamp and its associated data is
8 just one tool in the war of smuggling and diversion and
9 collection of excise taxes.

10 Just as a police force enhances its weapons
11 for better collection and enforcement, a stamp can be
12 used as a new tool in the state's arsenal for protection
13 of legitimate cigarette sales and revenue.

14 The new stamp and field tools together
15 enhance the likelihood of success and identifying and
16 seizing illicit product for all New York's enforcement
17 agents.

18 As evidenced by the success witnessed with
19 the program with the State of New York, and following
20 the recent decision by the Commonwealth of Massachusetts
21 to move forward with a similar program, stamp technology
22 can be an effective tool to enhance law enforcement
23 existing capability.

24 According to California Board of

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1 Equalization, also known as the BOE, the state has
2 recovered an additional \$110 million in tax revenues per
3 year. That's an extra from what they are already
4 collecting, \$110 million more since the implementation
5 of an encrypted tobacco tax stamp program.

6 New York has the largest number of
7 enforcement agents in the United States, yet even with
8 these resources New York has the single greatest trade
9 volume decrease in the nation. There's something
10 obviously going on.

11 While investigations and enforcement have

12 yielded arrests, states and municipal law enforcement
13 lack the advanced tools to effectively identify, pursue
14 and prosecute offenders, providing criminals and
15 terrorists an ideal market and environment to reach
16 significant profit at very little risk.

17 The State of New York has lost more than 50
18 percent of its stamp volume in recent years. That's a
19 hundred billion packs in 2000 to only approximately 479
20 million packs in 2009.

21 I personally don't believe 50 percent of the
22 smoking New Yorkers have quit. Some interest groups
23 will associate this number, though, to smoking cessation
24 measures and others will attribute most of this to

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1 tribal and internet sales. Most of us know this is not
2 the entire story.

3 At the same time, state revenues from
4 cigarettes have also decreased. In 2000, cigarette
5 excise tax revenue brought in about \$1.2 billion to
6 state coffers. In 2006, six years later, an after tax
7 increase revenue was down \$937 million.

8 That is over \$200 million decrease in
9 revenue. While such diversion affects the state's
10 revenues directly, legislators must equally be cognizant
11 of the loss of sales tax revenues to local communities.

12 Illicit sales also negatively affects
13 legitimate distributors and retailers who lose volume as
14 they are forced to compete with product sold at lower

15 costs.

16 A successful system would impede diversion
17 of legitimate untaxed cigarettes into the hands of
18 criminal organizations and prevent the insertion of
19 counterfeit products into a legitimate sales channel.

20 It would rejuvenate the enforcement
21 capability of the state's enforcement agent, thereby
22 reducing the supply of contraband cigarettes while
23 protecting the state's economy and citizens.

24 In closing, Governor Paterson most recently

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1 announced his plans to raise New York cigarette excise
2 tax from \$2.75 to a dollar more to \$3.75, which would
3 make it the very highest in the nation.

4 Governor Paterson believes that the dollar
5 increase in taxes would allow New York to collect an
6 additional \$218 million for the 2010-2011 fiscal year.

7 If there is anything that you remember from
8 my testimony, I want you to know that more likely,
9 however, this tax increase will further entice illicit
10 activity, and the state will not collect what it
11 actually estimates if there's no way to ensure that
12 taxes are collected in an efficient manner.

13 Should New York wish to collect additional
14 revenue, it should look to an upgraded version of the
15 current stamp which would help to recover tax revenues
16 already uncollected due to smuggling and diversion.

17 These tax revenues are so badly needed,
18 especially in New York State, and this is just one way
19 to help. SICPA thanks you for the opportunity to
20 provide testimony today. We are available should you
21 require any additional information on modern and
22 sophisticated state and federal stamping programs in the
23 future.

24 I will be happy to answer any questions.

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1 CHAIRMAN JOHNSON: We don't have any
2 questions. Thank you very much for your testimony.

3 MS. OZALTIN: Okay, thank you for your time.

4 CHAIRMAN JOHNSON: Thank you very much.

5 That completes -- that's our last witness.

6 It completes the hearing. I want to thank everybody who
7 attended and participated both in the October hearing.

8 State Senator Nozzolio, thank you so much
9 for your participation as well. I thank everybody. We
10 now adjourn this hearing and we will be presenting and
11 preparing our report in the near term.

12 Thank you.

13 (Hearing concluded.)

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